

Meredith A Jury, Esq., Of Counsel (SBN 71394)  
Summer Shaw, Esq. (SBN 283598)  
SHAW & HANOVER, PC  
44-901 Village Court, Suite B  
Palm Desert, CA 92260  
Telephone No:(760) 610-0000  
Facsimile No: (760) 687-2800  
Email: ss@shaw.law  
*Attorneys for Appellants, Marcus Albert Romero and  
Natalie Victoria Romero*

**UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA**

In re:

MARCUS ALBERT ROMERO and  
NATALIE VICTORIA ROMERO,

Debtors.

MARCUS ALBERT ROMERO and  
NATALIE VICTORIA ROMERO

Appellants,

vs.

TODD A FREALLY, CHAPTER 7  
TRUSTEE,

Appellee.

Chapter: 7

Bankruptcy Case No.: 6:22-bk-12942-WJ

Appeal No.: 5:23-CV-01010-fla

**OPENING BRIEF BY APPELLANTS  
MARCUS ALBERT ROMERO AND  
NATALIE VICTORIA ROMERO**

## Table of Contents

|  |           |
|--|-----------|
| <b>I. STATEMENT OF THE CASE .....</b>  | <b>5</b>  |
| <b>A. Factual and Procedural Background .....</b>  | <b>5</b>  |
| <b>B. What This Case is Really All About .....</b>   | <b>7</b>  |
| <b>II. JURISDICTIONAL STATEMENT .....</b>  | <b>9</b>  |
| <b>III. STATEMENT OF ISSUES .....</b>  | <b>10</b> |
| <b>IV. STANDARD OF REVIEW .....</b>  | <b>10</b> |
| <b>V. SUMMARY OF THE ARGUMENT .....</b>  | <b>11</b> |
| <b>VI. ARGUMENT .....</b>  | <b>15</b> |
| <b>A. <i>Jevic</i> Forbids the Use of the Carved-Out Equity to Pay Unsecured<br/>Creditors Before Paying the Homestead Exemption .....</b>                 | <b>15</b> |
| <b>B. The Analysis in and the Policy Behind <i>Tillman</i> Demands Reversal.....</b>   | <b>19</b> |
| <b>C. The Homestead Exemption Attaches to the Carveout.....</b>  | <b>24</b> |
| <b>D. Refusing to Compel Abandonment Based on A “Compromise Motion”<br/>Which Compromises Nothing Was An Abuse of the Court’s Discretion .....</b>         | <b>28</b> |
| <b>E. A “Compromise Motion” of A Nonexistent Controversy Is Not Proscribed<br/>by the Code, Even Under the Bankruptcy Court’s 105 Powers .....</b>         | <b>29</b> |
| <b>F. Bankruptcy Code Section 105, Longstanding Policies and Equity Weigh<br/>Against a Trustee Selling Fully Encumbered Property and Evicting Debtors</b> | <b>37</b> |
| <b>VII. CONCLUSION .....</b>   | <b>39</b> |

## Table of Authorities

### **Cases**

|  |               |
|--|---------------|
| <i>Cryzewski v Jevic Holding Corp.</i> , 580 U.S. 451 (2017) .....   | 7, 13, 16, 17 |
| <i>Debbie Reynolds Hotel &amp; Casino, Inc. v. Calstar Corp. (In re Debbie Reynolds Hotel &amp; Casino, Inc.)</i> , 255 F.3d 1061, 1065 (9th Cir. 2001)..... | 10            |
| <i>Elliott v. Four Seasons Props. (In re Frontier Props., Inc.)</i> , 979 F. 2d 1358 (9th Cir. 1992).....  | 9             |
| <i>Ewell v. Diebert (In re Ewell)</i> , 958 F.2d 276, 279 (9th Cir. 1992).....   | 10            |
| <i>Gebhart v. Gaughan (In re Gebhart)</i> , 621 F. 3d 1206, 1210 (9th Cir. 2010).....  | 19            |
| <i>In re A &amp; C Properties</i> , 784 F.2d 1377 (9th Cir. 1986).....   | 29, 30        |
| <i>In re Bunn-Rodemann</i> , 491 B.R. 132 (Bankr. E.D. Cal. 2013) .....  | 24            |
| <i>In re Christensen</i> , 561 B.R. 195 (Bankr. D. Utah 2016) .....  | passim        |
| <i>In re Cumberbatch</i> , 302 B.R. 675 (Bankr. C.D. Cal. 2003) .....  | 18            |
| <i>In re Kelley</i> , 300 B.R. 11 (9th Cir. BAP 2003).....   | 18            |
| <i>In re KVN</i> , 514 B.R. 1 (9th Cir. BAP 2014) .....  | 37, 38        |
| <i>In re Tovan Construction, Inc.</i> , 2021 WL 1235359 (Bankr. E.D. VA. 2021).....  | 18            |
| <i>In re Turnage</i> , 644 B.R. 656 (Bankr. W.D. N.C. 2022) .....  | 26, 27, 37    |
| <i>In re Wilson</i> , 494 B.R. 502 (Bankr. C.D. Cal. 2013).....  | 24, 25        |
| <i>J.P. Morgan Inv. Mgmt., Inc. v. U.S. Trustee (In re Martech USA, Inc.)</i> , 188 B.R. 847 (9th Cir. BAP 1995) .....                                       | 9             |
| <i>Jubber v. Bird (In re Bird)</i> , 577 B.R. 365 (10th Cir. BAP 2017) .....   | 20, 23, 38    |
| <i>Klein v. Chappell (In re Chappell)</i> , 373 B.R. 73, 76 (9th Cir. BAP 2007) .....  | 10            |
| <i>Lac du Flambeau Band of Lake Superior Chippewa Indians v Coughlin</i> , 599 U.S. ---, 143 S. Ct. 1689 (2023) .....  | 7             |
| <i>Law v. Siegel</i> , 571 U.S. 415 (2014).....  | 23            |
| <i>Owen v. Owen</i> , 500 U.S. 305 (1991).....   | 7, 19         |
| <i>Preblich v. Battley</i> , 181 F. 3d 1048 (9th Cir. 1999).....   | 9             |
| <i>Roach v. Marshack (In re Roach)</i> (B.A.P. 9th Cir. 2019) .....  | 34, 35, 36    |

|   |  |        |
|---|--|--------|
| 1 | <i>Slimick v Silva (In re Silva)</i> , 928 F. 2d 304 (9th Cir. 2007).....                      | 9      |
| 2 | <i>Stark v Pryor (In re Stark)</i> , 2022 WL 2316176 (E.D. N.Y. 2022) .....                    | 25, 26 |
| 3 | <i>Summerlin v. Turnage (In re Turnage)</i> , 648 B.R. 793 (W.D. N.C. 2023).....               | 26     |
| 4 | <i>Temecula v. LPM Corp. (In re LPM Corp.)</i> , 300 F.3d 1134, 1136 (9th Cir. 2002) .         | 10     |
| 5 | <i>U.S. v. Hinkson</i> , 585 F.3d 1247, 1251 (9th Cir. 2009).....                              | 11     |
| 6 | <i>United States v. Warfield (In re Tillman)</i> , 53 F. 4th 1160 (9th Cir. 2022)8, 13, 19, 20 |        |

## 7 Statutes

|    |                                     |                |
|----|-------------------------------------|----------------|
| 8  | 11 U.S.C. § 105 .....               | passim         |
| 9  | 11 U.S.C. § 363 .....               | 24             |
| 10 | 11 U.S.C. § 507 .....               | 7, 12, 16, 36  |
| 11 | 11 U.S.C. § 551 .....               | 18             |
| 12 | 11 U.S.C. § 554 .....               | 6              |
| 13 | 11 U.S.C. § 724 .....               | passim         |
| 14 | 11 U.S.C. § 726 .....               | 7, 12          |
| 15 | 11 U.S.C. §554(b) .....             | 27             |
| 16 | 11 U.S.C. Section 522 .....         | 28, 30, 31, 32 |
| 17 | 28 U.S.C. § 157 .....               | 8              |
| 18 | 28 U.S.C. § 158 .....               | 8              |
| 19 | Cal Code Civ. Proc. § 703.140.....  | 24             |
| 20 | Cal. Code Civ. Proc. § 704.710..... | 17             |
| 21 | Cal. Code Civ. Proc. § 704.730..... | 4, 17          |

## 22 Rules

|    |   |        |
|----|---|--------|
| 23 | Fed. Rules of Bankr. Pro. Rule 8002 ..... | 8      |
| 24 | Fed. Rules of Bankr. Proc. Rule 9019..... | passim |

## I. STATEMENT OF THE CASE

### A. Factual and Procedural Background

Debtors Marcus and Natalie Romero (the “Debtors”/“Appellants”) filed a chapter 7 bankruptcy petition on August 4, 2022.<sup>1</sup> Among the assets on their “Schedule A/B” (real and personal property) was their residence at 45119 Riverstone Court, Temecula, California (the “Residence”) with a value of \$1,254,300.00.<sup>2</sup> Their family of five lived in the Residence. They claimed a homestead exemption on the Residence in “Schedule C” (exemptions) under Cal. Code Civ. Proc. § 704.730 in the amount of \$53,464.40<sup>3</sup> but they amended Schedule C on February 17, 2023 to increase the claimed exemption to \$558,000.00 (Debtors’ homestead exemption).<sup>4</sup> The Debtors’ “Schedule D” (secured creditors) showed first trust deed holder Chase Bank was owed \$521,585.60; second trust deed holder Cenlar Mortgage was owed \$258,223.00; third trust deed holder Financial Casualty and Surety was owed \$250,000.00 (“3<sup>rd</sup> deed of trust”); and Riverside County Tax Collector was owed \$6,625.25.<sup>5</sup> In addition, the United States of America filed two tax liens against the Residence on April 5, 2022, with an approximate balance due of \$171,000 (“Tax Liens”).<sup>6</sup> These liens totaled approximately \$1,207,433, which, based on the Debtors’ valuation of the Residence, left no realizable equity in the property even without taking into consideration the Debtors’ homestead exemption.<sup>7</sup> The Debtors expected the fully encumbered Residence to pass through the chapter 7 proceeding and that they would deal with the secured debt outside of bankruptcy to keep their home for their family.<sup>8</sup>

<sup>1</sup> Excerpts of Record (“EOR”) 00013-00087. The EOR is consecutively paginated for ease of reference.

<sup>2</sup> EOR 00022.

<sup>3</sup> EOR 00031.

<sup>4</sup> EOR 00297.

<sup>5</sup> EOR 00033-00037.

<sup>6</sup> EOR 00035 & 00093.

<sup>7</sup> EOR 00593 [Transcript of the March hearing at page 20, lines 1-2.

<sup>8</sup> EOR 00221.

1           The chapter 7 trustee, Todd Frealy (the “Trustee”) had other ideas. On  
 2 February 10, 2023, he filed Trustee’s Motion to Approve Compromise under Rule  
 3 9019 (the “Compromise Motion”), and simultaneously filed Trustee’s Objection to  
 4 Debtors’ Claim of Exemptions (the “Homestead Exemption Motion”) (Compromise  
 5 Motion and Homestead Exemption Motion collectively the “Motions”).<sup>9</sup>  
 6 Underlying these Motions was a deal that the Trustee had brokered with the 3<sup>rd</sup> deed  
 7 of trust holder, Financial Casualty & Surety (“FCS”) whereby FCS would consent  
 8 to a sale of the Residence on the condition that it receive 60% of the net proceeds  
 9 due on the FCS trust deed from such sale after the first and second trust deed  
 10 holders were paid, and after the costs of sale and the real property taxes were paid,  
 11 with the remaining 40% due under the trust deed deemed a carveout for the benefit  
 12 of the bankruptcy estate. Under the Trustee’s calculations, if the property sold for  
 13 \$1,125,000, the sale would result in FCS receiving about \$150,000 and the estate  
 14 receiving about \$100,000.<sup>10</sup>

15           The Compromise Motion (which compromised absolutely nothing, as  
 16 discussed in Argument below) also asserted that the Trustee could ignore the  
 17 Debtors’ homestead exemption because it could not attach to the carveout. The  
 18 homestead exemption Motion expanded that argument, objecting to any homestead  
 19 exemption asserted by the Debtors and in particular arguing that the exemption  
 20 could not attach to the carveout, citing no precedential authority for that assertion.

21           The Debtors responded by filing a Motion to Compel Trustee to Abandon  
 22 Property of the Estate (the “Abandonment Motion”) on February 14, 2023.<sup>11</sup> They  
 23 argued that the fully encumbered Residence was burdensome to the estate based on  
 24 the ongoing mortgage and tax payments and was of inconsequential value and  
 25 benefit to the estate under section 554.

26  
 27  
 28 <sup>9</sup> EOR 00088-00155.

<sup>10</sup> EOR 00166.

<sup>11</sup> EOR 00218-00294.

1 A flurry of briefing followed the filing of these motions, with the Debtors  
 2 opposing the Trustee's Motions, the Trustee opposing the Debtors' Motion to  
 3 Compel Abandonment, and replies filed all around.<sup>12</sup> The bankruptcy court heard  
 4 the motions on March 7, 2023, at which time it made an oral tentative ruling which  
 5 would approve the Compromise Motion, deny the Abandonment Motion, and allow  
 6 the homestead exemption but not allow it to attach to the carveout.<sup>13</sup> However, both  
 7 parties had requested a continuance of the hearing, which the Court granted to May  
 8 2, 2023, so his oral tentative was not finalized on March 7. Before the continued  
 9 hearing, the Trustee filed supplemental points and authorities whereby he indicated  
 10 that the agreement with FCS had been changed from a carveout to an assignment of  
 11 a partial interest in FCS's deed of trust, attempting to make the agreement palatable  
 12 under an unpublished Ninth Circuit Bankruptcy Appellate Panel (BAP) ruling<sup>14</sup> that  
 13 had blessed such an assignment as proper (but under completely different facts as  
 14 discussed below).<sup>15</sup> After further argument, on May 2, 2023, the bankruptcy court  
 15 stuck with its tentative by approving the Compromise Motion, denying the  
 16 Abandonment Motion, and ruling that homestead exemption was allowed but could  
 17 not attach to the carveout, entering the Order on the same date.<sup>16</sup>

## 18 **B. What This Case is Really All About**

19 Debtors filed a chapter 7 while residing in a Residence that they owned which  
 20 was fully encumbered. Because the Residence had no realizable equity for the  
 21 estate, particularly when their homestead exemption was taken into account, they  
 22 had a reasonable expectation that the fresh start which a bankruptcy discharge  
 23 would give them (*Lac du Flambeau Band of Lake Superior Chippewa Indians v*  
 24 *Coughlin*, 599 U.S. ---, 143 S. Ct. 1689, 1697 (2023)) meant they could keep their

26 <sup>12</sup> EOR 00299-00571.

27 <sup>13</sup> EOR 00572-00604.

<sup>14</sup> *Roach v. Marshack (In re Roach)*, 2019 WL 408628 (9th Cir. BAP 2019).

28 <sup>15</sup> EOR 00494-00566.

<sup>16</sup> EOR 00605-00621.



1 home and deal with the secured debt outside bankruptcy, since secured debt passes  
2 through. *Owen v. Owen*, 500 U.S. 305, 308-309 (1991). Instead, an aggressive  
3 Trustee decided to take extraordinary steps to sell the home out from under the  
4 Debtors by making a deal with a junior secured creditor that had not attempted to  
5 foreclose on the Residence from its junior position, despite nonpayment. His  
6 scheme was intended to allow the estate to skirt the statutorily mandated distribution  
7 order set forth in the Bankruptcy Code sections 726(a) and 507, using part of  
8 secured debt to pay unsecured creditors who were lower in priority than the  
9 Debtors' homestead exemption.

10 The Supreme Court has forbidden such attempts to pay claims in an order  
11 which differs from that set forth in section 726 in *Cryzewski v Jevic Holding Corp.*,  
12 580 U.S. 451 (2017). The Trustee here may not pay the unsecured creditors and his  
13 expenses ahead of the Debtor's homestead exemption. In addition, the Ninth Circuit  
14 ruled in *United States v. Warfield (In re Tillman)*, 53 F. 4th 1160, 1168-69 (9th Cir.  
15 2022), that a claim of exemption *withdraws* the property from the bankruptcy estate.  
16 In *Tillman*, the circuit held that a trustee could not recover the penalty portion of a  
17 tax lien and use it for the benefit of the estate's unsecured creditors because the  
18 debtors' homestead exemption withdrew the property which was subject to the lien  
19 from the estate, such that the debtor had to deal with the lien outside of bankruptcy.  
20 As discussed more thoroughly in Argument below, the same reasoning prevents the  
21 Trustee here from snatching value for the unsecured creditors from the debtors'  
22 homestead exemption. The exemption should attach to any carved-out value.

23 This scheming cannot be tolerated by equity and sound policy. Debtors with  
24 fully encumbered property should be allowed to expect that they will keep their  
25 homes or at a minimum realize the value of their homestead exemptions before  
26 unsecured creditors get paid. The Summary of Argument and Argument sections  
27 below will demonstrate why reversal of this Order is compelled by Supreme Court  
28 and Ninth Circuit authority, bankruptcy court case law, sound policy and common



1 decency.

## 2 II. JURISDICTIONAL STATEMENT

3 The bankruptcy court order appealed covered three separate motions: Trustee's  
4 Motion to Approve Compromise Under Rule 9019, Trustee's Objection to Debtors'  
5 Claim of Exemptions, and Debtors' Motion to Compel Trustee to Abandon Property  
6 of the Estate. All three motions fall within the bankruptcy court's core jurisdiction  
7 as set forth in 28 U.S.C. § 157 (b)(2), specifically subsection (A), matters  
8 concerning the administration of the estate as to the Compromise Motion and the  
9 Abandonment Motion, subsection (B), allowance or disallowance of exemptions as  
10 to the Objection to Exemptions; and subsection (O) other proceedings affecting the  
11 liquidation of the assets of the estate, as to all three motions because the ultimate  
12 goal of the Trustee is to sell the debtors' house. Therefore, the bankruptcy court had  
13 jurisdiction under 28 U.S.C. § 157(b)(2). The district court has jurisdiction of this  
14 appeal under 28 U.S.C. § 158(a)(1).

15 The Order on appeal was entered by the bankruptcy court on May 2, 2023. The  
16 Notice of Appeal was filed on May 15, 2023, within 14 days of entry of the Order,  
17 so the appeal was timely. Rule 8002(a)(1).<sup>17</sup> The Order totally disposed of all the  
18 issues raised in the three motions by approving the compromise, allowing in part  
19 and disallowing in part the debtors' homestead exemption, and by denying the  
20 abandonment, without any conditions on the three dispositions. Therefore, the  
21 Order is final and appealable because it "end[s] any interim disputes from which  
22 appeal would lie." *Slimick v Silva (In re Silva)*, 928 F. 2d 304, 307 n. 1 (9th Cir.  
23 2007) (internal quotation marks and citations omitted). Also, an order can be  
24 appealed under the "flexible finality" doctrine if it "(1) resolves and seriously  
25 affects substantive rights and (2) finally determines the discrete issue to which it is  
26

---

27  
28 <sup>17</sup> Unless specified otherwise, all chapter and section references are to the  
Bankruptcy Code/the "Code," 11 U.S.C. §§ 101-1532, and all Rule references are to  
the Federal Rules of Bankruptcy Procedure.

addressed.” *Elliott v. Four Seasons Props. (In re Frontier Props., Inc.)*, 979 F. 2d 1358, 1363 (9th Cir. 1992). An order denying an exemption constitutes a final, appealable order. *Preblich v. Battley*, 181 F. 3d 1048, 1056 (9th Cir. 1999). A bankruptcy court order approving a compromise is a final, appealable order. *J.P. Morgan Inv. Mgmt., Inc. v. U.S. Trustee (In re Martech USA, Inc.)*, 188 B.R. 847, 849 (9th Cir. BAP 1995). The Order finally determined the discrete issues raised in the motions and is final.

### III. STATEMENT OF ISSUES

1. Whether the bankruptcy court erred in entering an order on the Chapter 7 trustee’s objection to the Debtors’ homestead exemption when the motion stated no actual objection to the exemption claimed and the ruling was nothing more than an advisory opinion from the bankruptcy court about how funds should be dispersed upon a future sale of the Debtors’ residence which was in violation of the Code, *Tillman*, and *Jevic* by ruling that the Trustee did not have to pay the Debtors’ homestead exemption from the sale proceeds.

2. Whether the bankruptcy court abused its discretion in approving a compromise/settlement where there was no compromise/settlement of a dispute between the lender and the Chapter 7 trustee.

3. Whether the bankruptcy court erred in denying the Debtors’ motion to compel abandonment of their residence where the Debtors’ homestead exemption was allowed in full triggering *Tillman*, the residence was overencumbered, and the Chapter 7 trustee had no lawful ability to sell the residence, pay the Debtors’ their homestead exemption, and make a meaningful distribution to unsecured creditors.

### IV. STANDARD OF REVIEW

The bankruptcy court’s factual findings are reviewed for clear error, and its conclusions of law are reviewed de novo. *Ewell v. Diebert (In re Ewell)*, 958 F.2d 276, 279 (9th Cir. 1992).

The bankruptcy court’s interpretation of the Bankruptcy Code and Rules are

1 reviewed de novo. *Temecula v. LPM Corp. (In re LPM Corp.)*, 300 F.3d 1134, 1136  
 2 (9th Cir. 2002). “The determination of a homestead exemption based on undisputed  
 3 facts is a legal conclusion interpreting statutory construction which is reviewed de  
 4 novo.” *Klein v. Chappell (In re Chappell)*, 373 B.R. 73, 76 (9th Cir. BAP 2007),  
 5 aff’d sub nom. *In re Gebhart*, 621 F.3d 1206 (9th Cir. 2010).

6 The bankruptcy court’s order approving a compromise is reviewed for an  
 7 abuse of discretion. *Debbie Reynolds Hotel & Casino, Inc. v. Calstar Corp. (In re*  
 8 *Debbie Reynolds Hotel & Casino, Inc.)*, 255 F.3d 1061, 1065 (9th Cir. 2001). The  
 9 “abuse of discretion” test requires this Court first to consider whether the  
 10 bankruptcy court identified the correct legal standard for decision of the issue before  
 11 it, and then to determine whether the bankruptcy court’s findings of fact, and its  
 12 application of those findings of fact to the correct legal standard, were illogical,  
 13 implausible, or without support in inferences that may be drawn from facts in the  
 14 record. *U.S. v. Hinkson*, 585 F.3d 1247, 1251 (9th Cir. 2009)

15 However, because the bankruptcy court suggested that “if a higher court  
 16 found that the bankruptcy court could not approve the compromise” because it  
 17 found there was no controversy, the bankruptcy court could get around such a ruling  
 18 by approving the agreement pursuant to section 105. Therefore, the order approving  
 19 the compromise motion should be reviewed de novo because it involves the  
 20 bankruptcy court’s legal conclusions interpreting statutory construction of section  
 21 105 and legal conclusions that it can authorize a different priority scheme of  
 22 payment to creditors under section 507 under its section 105 powers as well.

## 23 **V. SUMMARY OF THE ARGUMENT**

24 When property of a bankruptcy estate is “burdensome” or “of inconsequential  
 25 value and benefit to the estate” it must be abandoned from the estate. Such  
 26 burdensome property is most often overencumbered property such as a debtor’s  
 27 residence which has voluntary liens that exceed the value of the residence as is the  
 28 case here. Fortunately, for debtors who are already down on their luck and are

1 prepared to surrender in a chapter 7 whatever *non-exempt* assets they have in  
2 exchange for a fresh start, there is no statute or law that allows bankruptcy trustees  
3 to circumvent the exemptions created to leave a family with the essentials to start  
4 over, or further, to circumvent the priorities for payments from the estate to  
5 creditors. And yet, here, the Trustee has tried to create a façade of legitimacy,  
6 through his Stipulation with FCS, his Compromise Motion, and his Homestead  
7 Objection Motion which, together, unlawfully do circumvent these vital rights under  
8 the Code.

9 California's homestead exemption laws preclude execution sales of property  
10 that include a homestead if the sale proceeds are insufficient to pay that amount of  
11 value in full. A selling judgment creditor (of which the Trustee stands in the shoes)  
12 must pay the homestead exemption in cash, to the Debtors, upon a sale. Therefore,  
13 because the Trustee cannot pay the Debtors' homestead exemption in full, the  
14 Residence is exempt from the Trustee's forced sale and requires the bankruptcy  
15 court to order abandonment of the Residence from the bankruptcy estate.

16 Further, when one looks closely at the Compromise Motion, there is nothing  
17 actually being compromised between the Trustee and FCS; each *A & C* factor is  
18 discussed by the Trustee but there is no controversy asserted anywhere in his  
19 pleading to be compromised. There is also no statute or Federal Bankruptcy Rule  
20 asserted to support the "compromise" for which the Trustee sought to approve.  
21 Rather, the Stipulation and Compromise Motion seek the bankruptcy court's  
22 approval to enter into a scheme to transfer/sell a portion of a deed of trust secured  
23 against the Debtors' Residence, from FCS to the Trustee, and render the Debtors  
24 and their three (3) minor children homeless, by proposing that such scheme will  
25 allow a sale of the Debtors' Residence without payment of their homestead  
26 exemption.

27 Although the Trustee has not yet obtained an order authorizing sale of the  
28 //

1 Residence,<sup>18</sup> his intention is clear: he will market and sell the Residence, pay the  
 2 first and second consensual liens, pay 60% of the value of the FCS lien to FCS (as  
 3 determined by the portion of the lien which is secured by the purchase price), keep  
 4 the cash value of the other 40% to pay administrative expenses and unsecured  
 5 creditors pro rata,<sup>19</sup> and pay nothing to the Debtors as a result of the homestead  
 6 exemption. Debtors assert that by using what would otherwise be the value of their  
 7 homestead exemption to pay unsecured creditors, the Trustee is violating the order  
 8 of distributions from a bankruptcy estate as prohibited by the Supreme Court's  
 9 decision in *Jevic*. In *Jevic*, the debtors entered into a proposed structured  
 10 dismissal<sup>20</sup> which carved out a portion of a lienholder's secured value to pay  
 11 unsecured creditors who were lower in priority under the distribution scheme set  
 12 forth in sections 726(a) and 507 than an intervening class of priority creditors. The  
 13 Supreme Court reversed the bankruptcy court's approval of this structured  
 14 dismissal, holding that a bankruptcy court may not approve a dismissal that provides  
 15 for distributions that do not follow the Code's ordinary priority rules. The same  
 16 reasoning applies here, the only difference being that the intervening claim with a  
 17 higher priority than the unsecured creditors is the Debtors' homestead exemption, an  
 18 exemption provided by state law to shield equity in property from unsecured claims.  
 19 The Trustee's carveout creates that freed up equity, because FCS has given up a  
 20 portion of its secured value to the unsecured creditors. This runs afoul of *Jevic*.

21 The Trustee's proposed distribution of the carveout also violates the  
 22 principles laid down in *Tillman*. There, the Ninth Circuit described what happens  
 23 when a debtor claims an exemption in a homestead: the property is withdrawn from  
 24

---

25 <sup>18</sup> The Trustee has employed a real estate broker to accomplish such sale. If the  
 26 court approves the sale, the Debtors will appeal that Order as well.

27 <sup>19</sup> EOR 00494-00566

28 <sup>20</sup> A structure dismissal pertains to the dismissal of a chapter 11 case while  
 approving certain distributions to creditors, among other conditions on the  
 dismissal. *Jevic*, 580 U.S. at 457.

1 the estate. Any value of that property which a trustee attempts to recover under  
2 section 724(a) may not be used to benefit the estate because of this withdrawal.  
3 *Tillman*, 53 F. 4th at 1173-74. In the same fashion, the Trustee here is “recovering”  
4 or carving out a portion of a junior lien from property that is no longer property of  
5 the estate. He cannot use this non-estate property to pay estate creditors.

6 There is no precedential authority on whether a homestead exemption applies  
7 to a portion of a lien carved out for the benefit of the estate. Some bankruptcy court  
8 cases and district court cases have ruled that it does, because the *property* which  
9 gives it cash value has been exempted. Other cases have said it does not, asserting  
10 that the value was created by the trustee’s efforts or originally belonged to the  
11 secured creditor which is entitled to do with it whatever it wants (despite *Jevic*).  
12 Debtors submit that the cases which say the exemption does apply to the carveout  
13 are better reasoned and should be persuasive to this court.

14 Finally, section 105 of the Code gives the bankruptcy courts the power to  
15 make orders which are necessary to implement the provisions of the Code. Debtors  
16 assert that included in those provisions are the policy behind the fresh start which a  
17 chapter 7 discharge is meant to assure to the honest but unfortunate debtors. No one  
18 here argues that the Debtors are not honest and unfortunate. Included in that policy  
19 is the concept that chapter 7 trustees should not ordinarily seek to liquidate  
20 overencumbered property such as the Residence, particularly when it would  
21 unhouse a family of five. Secured debt passes through bankruptcy and debtors  
22 should be given the opportunity to deal with it outside the case, as was the intent of  
23 these Debtors. An aggressive trustee and a third priority lienholder with no intent to  
24 foreclose have schemed to take these Debtors’ dream away. Public policy cannot  
25 countenance such acts.

26 //

27 //

28 //

## VI. ARGUMENT

### A. *Jevic* Forbids the Use of the Carved-Out Equity to Pay Unsecured Creditors Before Paying the Homestead Exemption

The bankruptcy court made a telling statement while ruling for the Trustee in its oral tentative announced on March 7, 2023:

“A lender can do whatever they want. A secured lender can do whatever it wants with its cash collateral. It can do whatever it wants with the proceeds of its loan. It can do whatever it wants with its lien.”

Transcript of Proceedings, March 7, 2023, p. 23, lines 7-10.<sup>21</sup>

Many might have thought that to be the case before *Jevic*. In fact, that is what the debtors and certain secured creditors thought could happen in the proposed structured dismissal in that case. When Jevic Holdings (“Jevic”) filed its chapter 11 petition, it owed senior secured debt to its parent company Sun Capital Partners (“Sun”) and CIT Group. Before filing bankruptcy, Jevic had ceased operations and laid off truckdrivers without following the requirements of the federal Worker Adjustment and Retraining Notification Act (WARN Act) which requires a 60-day notice before termination. The truckdrivers sued Jevic and Sun and obtained summary judgment against Jevic, which was accorded priority status as a claim in the chapter 11 because it was based on wage claims of the truckdrivers. The litigation continued against Sun.

In addition, the Unsecured Creditors Committee (the “Committee”) sued Sun and CIT, on behalf of the estate, over the leveraged buyout which led to Jevic’s financial distress, asserting fraudulent transfer claims. Subsequently, Sun, CIT, Jevic and the Committee negotiated a settlement which would resolve the Committee’s lawsuit and allow dismissal of the chapter 11 by: (1) CIT depositing \$2 million into an account to pay the Committee’s legal fees and administrative expenses; and (2) Sun assigning its lien on Jevic’s assets, worth about \$1.7 million,

---

<sup>21</sup> EOR 00596 at lines 7-10.



1 to a trust to pay taxes and other administrative expenses and then distribute the  
 2 remainder pro-rata to the general unsecured creditors. The settlement specifically  
 3 did not provide for payments to the priority wage creditors because Sun, the source  
 4 of the funds, was still litigating at that time with the truckdrivers and didn't want to  
 5 finance that litigation. The bankruptcy court approved this settlement, including the  
 6 distribution scheme, over objections from the truckdrivers and the United States  
 7 Trustee about the order of distribution, but the Supreme Court struck it down  
 8 because it failed to follow the distribution order set forth in section 726(a).

9 The Supreme Court noted that the Code's priority system is usually  
 10 implemented when the assets of a debtor's estate are distributed at the termination  
 11 of a case, whether in a chapter 7 or a liquidating chapter 11. It is "fundamental to  
 12 the Bankruptcy Code's operation... 'designed to enforce a distribution of the  
 13 debtor's assets in an orderly manner...in accordance with established principles  
 14 rather than on the basis of the inside influence or economic leverage of a particular  
 15 creditor.'" *Jevic*, 580 U.S. at 465 (quoting from H.R. Rep. No. 103-835, p. 33  
 16 (1994).)

17 Section 726(a)<sup>22</sup> provides for the distribution of estate assets, after secured  
 18 creditors have been paid from their collateral, according to the priority order set  
 19

20 <sup>22</sup> Section 726(a) provides:

21 **(a)** Except as provided in section 510 of this title, property of the estate shall  
 22 be distributed—

23 **(1)** first, in payment of claims of the kind specified in, and in the order  
 24 specified in, section 507 of this title, proof of which is timely filed  
 25 under section 501 of this title or tardily filed on or before the earlier of—

26 **(A)** the date that is 10 days after the mailing to creditors of the  
 27 summary of the trustee's final report; or

28 **(B)** the date on which the trustee commences final distribution under  
 this section;

**(2)** second, in payment of any allowed unsecured claim, other than a claim of  
 a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which  
 is—

**(A)** timely filed under section 501(a) of this title;

1 forth in section 507. The order of priority set forth in section 507 (a) is, in general  
 2 terms as applicable, first to administrative expenses and domestic support  
 3 obligations, then to other priority claims such as wage claims and taxes, then to  
 4 general unsecured creditors, and finally to equity holders. The Supreme Court noted  
 5 that the proposed distribution of the funds assigned from the secured claim of Sun  
 6 was to pay the unsecured creditors rather than the higher priority claim of the  
 7 truckdrivers. This was a violation of the distribution scheme set forth in Code and  
 8 could not be countenanced over the objection of any higher priority claimant, such  
 9 as the truckdrivers. Beyond just the words of the statutes, the Supreme Court  
 10 bolstered its ruling by acknowledging the policies behind strictly adhering to the  
 11 codified priority order: avoiding the “risks of collusion, i.e., senior secured  
 12 creditors and general unsecured creditors teaming up to squeeze out priority  
 13 unsecured creditors.” *Jevic*, 580 U.S. at 470. It refused to alter the balance set forth  
 14 in the Code and ruled that Sun could not give the monetary value of its secured  
 15

---

16 **(B)** timely filed under section 501(b) or 501(c) of this title; or

17 **(C)** tardily filed under section 501(a) of this title, if—

18 **(i)** the creditor that holds such claim did not have notice or actual  
 19 knowledge of the case in time for timely filing of a proof of such  
 20 claim under section 501(a) of this title; and

21 **(ii)** proof of such claim is filed in time to permit payment of such  
 22 claim;

23 **(3)** third, in payment of any allowed unsecured claim proof of which is tardily  
 24 filed under section 501(a) of this title, other than a claim of the kind specified  
 25 in paragraph (2)(C) of this subsection;

26 **(4)** fourth, in payment of any allowed claim, whether secured or unsecured,  
 27 for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive  
 28 damages, arising before the earlier of the order for relief or the appointment  
 of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not  
 compensation for actual pecuniary loss suffered by the holder of such claim;

**(5)** fifth, in payment of interest at the legal rate from the date of the filing  
 of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this  
 subsection; and

**(6)** sixth, to the debtor.

1 claim to the estate for payment to unsecured creditors when a higher priority  
2 creditor objected.

3 Just like Sun in *Jevic*, FCS proposes to carve out or assign (there is no  
4 practical difference here based on the ruling in *Jevic* which considered an  
5 assignment) a portion of the monetary value of its junior secured lien for the estate  
6 to use to pay unsecured creditors, lower in priority than the tax liens on the property  
7 held by the IRS. But the IRS did not object. So, you might ask, where is the higher  
8 priority objecting creditor or, in this instance, claim? It is the allowed homestead  
9 exemption of the Debtors.

10 The California automatic homestead exemption applicable in this case is set  
11 forth in Cal. Code Civ. Proc. §§ 704.710, et seq. and was enacted long ago to protect  
12 equity in a judgment debtor's homestead property from judgment creditors who did  
13 not hold a voluntary lien on the debtor's property. § 704.720; *In re Kelley*, 300 B.R.  
14 11 (9th Cir. BAP 2003). Such exemption is automatic, in the sense that it arises by  
15 operation of law with no overt act required of the homeowner. *In re Cumberbatch*,  
16 302 B.R. 675 (Bankr. C.D. Cal. 2003). It protects debtor's homestead from a forced  
17 sale. A bankruptcy proceeding has been interpreted to be identical to a forced sale;  
18 if the trustee tries to liquidate the debtor's home, he is standing in the shoes of a  
19 judgment creditor conducting an involuntary sale. *Kelley*, 300 B.R. at 20.

20 In every sense, the Debtors' allowed homestead exemption in this case stands  
21 between equity in the property remaining after all secured claims have been paid  
22 and money going to pay the unsecured creditors or administrative expenses of the  
23 estate. It is higher in priority than administrative expenses and unsecured claims of  
24 the estate. The Trustee here would not have dreamed of selling the Debtors' home  
25 and taking the net proceeds from the sale while ignoring the homestead exemption.  
26 He knows he cannot touch that protected equity. But he believed what the  
27 bankruptcy court said in its ruling: "A secured creditor can do whatever it wants  
28 with its cash collateral." *Jevic* says no. The bankruptcy court was wrong. The

Trustee was wrong. The Compromise approved by the bankruptcy court and the distribution scheme it contemplates after sale contravenes established precedent. Reversal is necessary.<sup>23</sup>

#### **B. The Analysis in and the Policy Behind *Tillman* Demands Reversal**

The issue before the Ninth Circuit in *Tillman* was admittedly different than the one before this Court. However, the language and policies stated in the opinion, as well as the arguments by the trustee which the Circuit struck down, reflect a precedent which this Court cannot ignore. The trustee in *Tillman* sought to use the provisions of section 724(a)<sup>24</sup> to avoid the penalty portion of an IRS lien on the debtor's home and preserve the monetary value of that lien under section 551<sup>25</sup> for the benefit of the estate, i.e., administrative expenses and unsecured creditors. *Tillman*, 53 F. 4th at 1165. The IRS objected, arguing that section 724(a) avoidance and section 551 preservation did not apply to exempt property. The debtor had exempted her home using the applicable Arizona homestead exemption. The Circuit agreed with the IRS, reversing the bankruptcy court's approval of the motion.

After discussing the nature of the homestead exemption, it said repeatedly “an exemption is an interest *withdrawn* from the estate (and hence from the creditors) for the benefit of the debtor.’ *Owen*, 500 U.S. 308. [*Owen v. Owen*, 500 U.S. 305 (1991)].” *Tillman*, 53 F. 4th at 1168 (emphasis in the original). It also

---

<sup>23</sup> In *In re Tovan Construction, Inc.*, 2021 WL 1235359 (Bankr. E.D. VA. 2021), the bankruptcy court used the reasoning of *Jevic* when denying approval of a compromise which intended to use payments to the estate by the debtor's principal and a related entity to pay a particular creditor, violating the distribution priority order.

<sup>24</sup> Section 724(a) provides: “The trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title.”

<sup>25</sup> Section 551 provides: “Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.”

1 cited to its own authority on that issue, *Gebhart v. Gaughan (In re Gebhart)*, 621 F.  
 2 3d 1206, 1210 (9th Cir. 2010) for the statement “[a]fter the commencement of  
 3 bankruptcy proceedings, property interests which are exempted by a debtor are  
 4 ‘withdrawn from the estate’,” noting that after exemption the property reverts in the  
 5 debtor. *Tillman*, 53 F. 4th at 1168. It rejected the reasoning of the bankruptcy court  
 6 that “it was only the Debtor’s equity beyond the mortgage and tax lien that the  
 7 debtor was entitled to exempt.” *Id.*, at 1165. It also overruled the district court  
 8 affirmance, where that court stated “that the Debtor was only entitled to use  
 9 Arizona’s homestead exemption to exempt unencumbered property – i.e., the  
 10 exemption excluded the mortgage and the IRS lien.” The Circuit disagreed. *Id.*, at  
 11 1166.

12 Debtors here have an allowed homestead exemption. As a result, the  
 13 Residence has been withdrawn from the estate, subject to the three trust deeds and  
 14 the IRS tax liens, which the Debtors must deal with outside of the bankruptcy  
 15 proceedings. The Trustee cannot make a deal with one of those secured creditors to  
 16 recapture the withdrawn property and sell it to benefit creditors who are junior to the  
 17 homestead exemption. It does not matter, per *Tillman*, that the Debtors had no  
 18 realizable equity in the Residence when they filed. It reverted in them, nevertheless,  
 19 leaving them with the obstacles they knew they faced when they filed bankruptcy:  
 20 the obligation to deal with that secured debt on their own. *Tillman* reaffirms that  
 21 expectation.

22 The legal conclusions and policies espoused in *Tillman* resound in a  
 23 bankruptcy case and its appeal to the Tenth Circuit BAP, *In re Christensen*, 561  
 24 B.R. 195 (Bankr. D. Utah 2016) and *Jubber v. Bird (In re Bird)*, 577 B.R. 365 (10th  
 25 Cir. BAP 2017). In *Christensen*<sup>26</sup>, the debtors’ residences were encumbered by  
 26

---

27  
 28 <sup>26</sup> The *Christensen* case actually involved two different debtors, Christensen and  
 Bird, with identical factual scenarios and identical actions by the same trustee, so  
 the bankruptcy court resolved both with one published opinion.

1 liens which exceeded their value on the petition date and both debtors properly  
 2 exempted their homesteads. Among the encumbrances was an IRS lien which was  
 3 junior to voluntary mortgages. The trustee in *Christensen* sought to use the  
 4 provisions of 724(b)<sup>27</sup> to subordinate the IRS liens to the estate's interest so that he  
 5 could sell the property and claim the value of those liens for the estate to pay,  
 6 among other things, his administrative expenses with a small distribution to  
 7 unsecured creditors. The proposed distribution from the sale did not pay anything to  
 8 the debtors based on their homestead exemptions, which were allowed by the  
 9

10 <sup>27</sup> Section 724(b) provides:

11 (b) Property in which the estate has an interest and that is subject to a lien  
 12 that is not avoidable under this title (other than to the extent that there is a properly  
 13 perfected unavoidable tax lien arising in connection with an ad valorem tax on real  
 14 or personal property of the estate) and that secures an allowed claim for a tax, or  
 15 proceeds of such property, shall be distributed--

16 (1) first, to any holder of an allowed claim secured by a lien on such  
 17 property that is not avoidable under this title and that is senior to such tax  
 18 lien;

19 (2) second, to any holder of a claim of a kind specified in section  
 20 507(a)(1)(C) or 507(a)(2) (except that such expenses under each such  
 21 section, other than claims for wages, salaries, or commissions that arise  
 22 after the date of the filing of the petition, shall be limited to expenses  
 23 incurred under this chapter and shall not include expenses incurred under  
 24 chapter 11 of this title), 507(a)(1)(A), 507(a)(1)(B), 507(a)(3), 507(a)(4),  
 25 507(a)(5), 507(a)(6), or 507(a)(7) of this title, to the extent of the amount  
 26 of such allowed tax claim that is secured by such tax lien;

27 (3) third, to the holder of such tax lien, to any extent that such holder's  
 28 allowed tax claim that is secured by such tax lien exceeds any amount  
 distributed under paragraph (2) of this subsection;

(4) fourth, to any holder of an allowed claim secured by a lien on such  
 property that is not avoidable under this title and that is junior to such tax  
 lien;

(5) fifth, to the holder of such tax lien, to the extent that such holder's  
 allowed claim secured by such tax lien is not paid under paragraph (3) of  
 this subsection; and

(6) sixth, to the estate.



1 bankruptcy court. Section 724(b) operates similarly to section 724(a) but allows the  
 2 trustee to subordinate the entire amount of the tax lien to pay senior encumbrances  
 3 and administrative priority expenses of the estate. The debtors opposed the trustee's  
 4 plans. However, to assure they could keep their homes, they converted their cases  
 5 to chapter 13, which made the sale efforts moot and ended the costly litigation. In  
 6 the chapter 13 cases, the trustee and his counsel filed fee applications as a basis for  
 7 priority claims they asserted must be paid in those proceedings. The ruling on these  
 8 fee applications resulted in the published opinion, with the bankruptcy court  
 9 denying the fees as not being based on services which were required for  
 10 administration of the estates. *Christensen*, 561 B.R. at 198.

11 The bankruptcy court first cited to the generally accepted principle that  
 12 trustees should not seek to sell fully encumbered property (discussed more fully in  
 13 Part F of Argument): “‘it is universally recognized...that the sale of a fully  
 14 encumbered asset is generally prohibited’ (citation omitted).” The court then  
 15 characterized the subordination of the IRS liens as a carveout, because it proposed  
 16 to take a portion of the cash value of a subordinate lien for the benefit of the estate.  
 17 It concluded the proceeds from the sale were subject to the exemptions claimed by  
 18 the debtors, analogizing the situation to one where “the secured creditor caps its  
 19 claim in an amount that is less than the value of the debtor’s interest in the property,  
 20 [so] the remaining value of the debtor’s interest in that property is subject to other  
 21 claims or interests,” including exemptions. *Christensen*, 561 B.R. at 209.

22 The court criticized any scheme where carveouts were used by secured  
 23 creditors or trustees to direct payments to other creditors, administrative or  
 24 otherwise. It held that a trustee cannot simply by agreement or use of section 724(b)  
 25 defeat junior liens or the homestead exemption. *Id.* at 210-211. It then analyzed  
 26 sections 724 and 506( c)<sup>28</sup> of the Bankruptcy Code and concluded neither provided  
 27

28 <sup>28</sup> Section 506(c) provides: “The trustee may recover from property securing an  
 allowed secured claim the reasonable, necessary costs and expenses of preserving,



1 a basis for a carveout. *Id.* at 213-215. It similarly concluded that the trustee could  
 2 not sell the properties free and clear of the homesteads because they were not in  
 3 dispute. *Id.* at 208-209.

4 The *Christensen* court finished with a robust criticism of the trustee's  
 5 endeavors to sell the debtors' homes without recognizing the homestead  
 6 exemptions: "Exemptions are a bulwark against destitution, but one that is not  
 7 immune from being undermined, circumvented, or torn down. A trustee should not  
 8 eviscerate a debtor's fresh start by seeking to disallow validly claimed exemptions."  
 9 *Id.* at 216. Using this sound reasoning, the bankruptcy court denied the fees.

10 The court here may use similar reasoning to deny the Compromise and the  
 11 distribution scheme it contemplates from a proposed sale which ignores the  
 12 homestead exemption on property withdrawn from the estate.

13 In *Bird* the Tenth Circuit BAP affirmed *Christensen* in all respects, reciting  
 14 the principles which generally forbid a trustee from selling fully encumbered  
 15 property and concluding the trustee should have abandoned the residences. *Bird*,  
 16 577 B.R. at 374-379. It reinforced the bankruptcy court's focus on the importance of  
 17 preserving homestead exemptions and eschewed any trustee manipulation of the  
 18 Code which would bypass that exemption to use proceeds from the sale of the  
 19 property to pay administrative expenses or unsecured creditors while disregarding  
 20 the proscribed priorities of distribution. *Id.* at 379-381. Although *Bird* was decided  
 21 before *Jevic*, it did rely on Supreme Court authority for its conclusions, noting that  
 22 in *Law v. Siegel*, 571 U.S. 415 (2014), the Court ruled that exemptions can be  
 23 denied only on statutory bases enumerated in the Code. *Bird*, at 386.

24 The case at bar is not a tax lien carveout matter, but the effect of what the  
 25 Trustee proposes to do is exactly the same: create equity from a property sale based

26 \_\_\_\_\_  
 27 or disposing of, such property to the extent of any benefit to the holder of such  
 28 claim, including the payment of all ad valorem property taxes with respect to the  
 property."

1 on a carveout from a junior secured creditor. The Trustee and that creditor then  
 2 devise a plan to use that cash value to skip the Debtors' homestead exemption on  
 3 property which has been withdrawn from the estate and pay administrative expenses  
 4 and the lower priority class of unsecured creditors. The *Tillman*, *Christensen*, and  
 5 *Bird* courts concluded such a plan must fail. This court may do the same.

### 6 **C. The Homestead Exemption Attaches to the Carveout**

7 Debtors recognize there is no controlling precedent on the issue of whether an  
 8 allowed homestead exemption attaches to funds carved out from the cash value of a  
 9 secured creditor's claim for the benefit of the estate.<sup>29</sup> There was a small flurry of  
 10 cases on the issue ten years ago when a few trustees were offered carveouts by first  
 11 position secured creditors to do short sales in bankruptcy so that creditor could  
 12 avoid the California nonjudicial foreclosure sale process. Those trustees proposed  
 13 to use the carved out funds to pay administrative expenses and small distributions to  
 14 unsecured claims while essentially evicting the debtors from their homes without  
 15 paying anything on their exemptions. The two bankruptcy cases of note in the  
 16 Ninth Circuit came to opposite conclusions. *In re Wilson*, 494 B.R. 502 (Bankr.  
 17 C.D. Cal. 2013), held that the exemption did attach to the carveout. *In re Bunn-*  
 18 *Rodemann*, 491 B.R. 132 (Bankr. E.D. Cal. 2013) ruled they did not attach. Since  
 19 that time, a paucity of cases with split outcomes have also addressed the issue.  
 20 Debtors submit those which allow the homestead exemption to attach are better  
 21 reasoned.

22 In *Wilson*, the debtor asserted a wildcard exemption of about \$26,000 in one  
 23 of two overencumbered properties which she owned when she filed a chapter 7  
 24

---

25 <sup>29</sup> The Trustee at the last minute changed the terminology of his deal with FCS from  
 26 a carveout to an assignment of a partial interest in FCS's trust deed in hopes of  
 27 using more a palatable term. Debtors submit it is a distinction without a difference  
 28 because the effect is exactly the same: a portion of the cash value that FCS would  
 be entitled to upon sale of the fully encumbered property will be paid to the estate.  
 Whether an assignment or a carveout, it skips the homestead exemption if used to  
 pay lower priority claims. In *Jevic* it was an assignment and forbidden.

1 bankruptcy. The wildcard exemption is provided by Cal Code Civ. Proc. §  
 2 703.140(b)(1) and (5), which allow a debtor a limited monetary exemption  
 3 (modified every three years) in a residence or, if not used for that, any other  
 4 property; its effect in this setting is identical to the homestead exemption up to the  
 5 statutory limit of the wildcard. The trustee negotiated a carveout from the first  
 6 lienholder, which she proposed to use for the benefit of the estate. The debtor  
 7 objected and said she must be paid her exemption from the sale proceeds before  
 8 anything went to the estate. The bankruptcy court ruled for the debtor, remarking  
 9 that “the Trustee is confusing exemptions, on the one hand, with the estate property  
 10 upon which the exemptions attach, on the other hand.” *Wilson*, 494 B.R. at 505. It  
 11 noted that it was not the carveout which was the asset upon which the debtor held an  
 12 exemption, but the real property which created the value (upon sale) from which the  
 13 carveout came. The trustee intended to sell the property under section 363 of the  
 14 Code. Such sale was subject to all attached interests in the property, whether it be a  
 15 secured claim or the homestead exemption, and those interests must be paid before  
 16 the estate would receive anything. *Id.*, at 506. It did not matter that the carveout  
 17 created the available funds, because before those funds could reach the estate all  
 18 those interests must be paid, including the exemption. Therefore, the exemption  
 19 attached to the carved out funds.

20 The District Court for the Eastern District of New York recently reversed a  
 21 bankruptcy court ruling which failed to apply a homestead exemption to a carveout,  
 22 called in that case a “give up.” *Stark v Pryor (In re Stark)*, 2022 WL 2316176 (E.D.  
 23 N.Y. 2022). Its analysis was similar to that in *Wilson*. In that matter the debtor  
 24 acknowledged her residence had no equity when she filed a chapter 7. The trustee  
 25 negotiated a carveout of an unknown sum (subject to the property’s value which  
 26 was unknown) and moved to sell the property with the carveout going to the estate.  
 27 The debtor objected, not to the sale itself, but to the distribution of the carveout  
 28 which she asserted was subject to her homestead exemption. The bankruptcy court

1 allowed the sale on the trustee's terms but the district court disagreed, holding that  
2 the exemption attached to the carved out funds.

3 Analyzing New York exemption law, which is similar to California's on these  
4 points, the district court noted that the statute exempted property which was land  
5 and a dwelling which the debtor owned and occupied. The trustee's carveout  
6 agreement created equity in that property, which was "extracted from 'value' in the  
7 property" that was covered by the homestead. Without that property, there would  
8 be no value upon sale: "If not [from the property's value], where does it come  
9 from?" *Id.* at \*5. Furthermore, "[a]t the end of the day, the Trustee is monetizing  
10 part of the value of 'a lot of land with a dwelling thereon' that is 'owned and  
11 occupied as a principal residence.' And that value is exempted by the New York  
12 homestead exemption statute." *Id.* at \*6. Just as in *Wilson*, the district court  
13 focused on the real property which held the value that became available as equity  
14 after the secured creditor's give up. The exemption attached to that property and  
15 similarly attached to the carveout.

16 A bankruptcy court and a district court also defeated a scheme between the  
17 IRS and taxing authorities to deny a 65-year-old debtor her homestead exemption in  
18 *In re Turnage*, 644 B.R. 656 (Bankr. W.D. N.C. 2022) and *Summerlin v. Turnage*  
19 (*In re Turnage*), 648 B.R. 793 (W.D. N.C. 2023). Similar to *Christensen* discussed  
20 above, the Turnage trustee proposed a deal with the taxing authorities to use section  
21 724(b) to subordinate a portion of a tax lien to pay administrative expenses and then  
22 priority creditors, which were the same tax authorities. The subordinated (carved  
23 out) funds would not be applied to the homestead exemption because the trustee  
24 asserted that the exemption did not apply to tax liens, nor would it apply to estate  
25 funds based on those tax liens. Both courts rejected that argument because it altered  
26 the statutory priority distribution scheme, stated most succinctly by the district  
27 court:

28 //

1            “[T]he Court finds that the carved-out funds are subject to the Debtor’s  
2            homestead exemption. The Trustee’s argument that because the carved-  
3            out funds would otherwise go to the tax liens the homestead exemption  
4            is inapplicable is unconvincing. If the Court adopted the Trustee’s  
5            position, it would be letting the Trustee and the tax agencies bind the  
6            Court and dictate payments to other creditors, this would be improper.  
7            The Trustee and tax agencies cannot defeat the Debtor’s homestead  
8            exemption by agreement.... once the tax agencies agree to the carve-out  
9            they cannot direct the allocation of the value created by such carve-out.”

10        *In re Turnage*, 648 B.R. at 798.

11            To put it mildly, both these court were outraged by the trustee’s plan because  
12            it deprived a debtor of her exemption in her residence for the benefit of the trustee,  
13            among others. Debtors here are outraged that their Trustee, in collusion with junior  
14            secured creditor FCS, which had demonstrated no inclination to foreclose on their  
15            house, brokered a deal which would bypass their homestead exemption to pay lower  
16            priority unsecured creditors.

17            The bankruptcy court in *Christensen* also concluded that the debtors’  
18            homestead exemptions attached to the proposed carveouts. “[I]f the secured creditor  
19            caps its claim in an amount that is less than the value of the debtor’s interest in the  
20            property, the remaining value of the debtor’s interest in the property is subject to  
21            other claims or interest, if any” which would include the debtors’ homestead  
22            exemptions before any funds go to the estate. *Christensen*, 561 B.R. at 207-208.

23            These cases all present a uniform view. The asset which generated the cash  
24            value which is carved out is the real property to which the debtors’ homestead  
25            exemption attached. Without that property, there is no value to anyone. Therefore,  
26            since the exempted property creates the value in question, the exemptions apply to  
27            that value before a lower priority claim may be paid. The reasoning is simple. It is  
28            correct.

**D. Refusing to Compel Abandonment Based on A “Compromise Motion”  
Which Compromises Nothing Was An Abuse of the Court’s Discretion**

11 U.S.C. §554(b) of the bankruptcy code (the “Code”) states:

“(b) On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.”

The Code does not further go on to say...unless the Trustee and a secured creditor on property of the estate can come up with a manufactured controversy to get around paying a debtor’s exemption on the property and circumvent the priority scheme of payments to creditors under the Code through a “compromise” motion, where there is no dispute to compromise, or through a “carve-out” of a secured creditor’s lien that will benefit the Trustee with a small dividend to creditors. However, that is exactly what happened in the case at hand.

Pursuant to 554(b), the Debtors filed the Abandonment Motion because the Residence was overencumbered, which is not in dispute. There was no equity in the Residence, even before taking into account the Debtors’ homestead exemption and the Tax Liens, as discussed in the facts above. Therefore, the Residence was “of inconsequential value and benefit to the estate” and “burdensome” with its growing mortgages and property tax debts secured against it, making abandonment the only appropriate action to be ordered by the bankruptcy court.

However, the bankruptcy court espoused that even if “some higher court concluded that [the Trustee’s deal with FCS was] not a 9019 motion,” it could be considered a “105 motion”<sup>30</sup> by which the bankruptcy court could order the same result. That result was that the Debtors’ homestead exemption did not have to be paid from a sale of the Residence, even though California law required, it subject to a few inapplicable limitations in section 522 of the Code. However, as will also be

---

<sup>30</sup> EOR 00594 at lines 17-21.

discussed in further detail below, section 105 does not give the bankruptcy court the authority to order what it did here. The granting of the Compromise Motion was not a lawful way to create nonexempt equity in the Residence and, therefore, the bankruptcy court exceeded its discretion in denying the Debtors' Abandonment Motion and it must be reversed.

**E. A "Compromise Motion" of A Nonexistent Controversy Is Not Proscribed by the Code, Even Under the Bankruptcy Court's 105 Powers**

Under the guise of Rule 9019, which allows a bankruptcy court to "approve a compromise or settlement" by a trustee with another party, the Trustee sought permission to essentially receive a transfer/"assignment" of a portion of FCS's 3<sup>rd</sup> deed of trust on the Residence, in exchange for an agreement by the Trustee to seek approval from the bankruptcy court to sell the Debtors' Residence out from under the Debtors (i.e. not pay their homestead exemption), allowing FCS to circumvent normal California foreclosure laws and timing requirements as well as California homestead exemptions.

First, as discussed above, and is clear from the Trustee's analysis in the Compromise Motion, there is no compromise of any controversy between the Trustee and FCS. The Trustee goes through the analysis of the required *A&C* Factors<sup>31</sup> in the 9<sup>th</sup> Circuit, but quite ethically, to his credit, does not misrepresent that there is some controversy applicable to any of the factors.<sup>32</sup> Under the requirement of analyzing the "Probability of Success in Litigation"<sup>33</sup> the Trustee speaks of no current or prospective litigation that could be brought against the estate by FCS or vice versa; and under "Difficulties in Collection"<sup>34</sup> the Trustee alleges no

<sup>31</sup> See *In re A & C Properties*, 784 F.2d 1377, 1380 (9th Cir. 1986) for the "A & C Factors."

<sup>32</sup> EOR 00097 at line 24 through 00099 at line 14.

<sup>33</sup> EOR 00097 at line 24 through 00098.

<sup>34</sup> EOR 00098 at lines 1-4.



1 debt that would need to be collected from FCS ever. But here is where things get a  
 2 bit murky, legally. Under the “Complexity of the Issues”<sup>35</sup> involved in related  
 3 litigation, there is no discussion at all other than the Trustee stating that the “legal  
 4 issues involved are not overly complex;” however, the Trustee mentions no “legal  
 5 issues” being litigated or even in controversy. Under the “Best Interests of  
 6 Creditors”<sup>36</sup> heading, where there would typically be a discussion about whether  
 7 ceasing litigation and entering into a “settlement” is better for creditors than  
 8 continuing litigation,<sup>37</sup> there is simply a discussion about how the Trustee signing  
 9 the Stipulation/agreement with FCS will pay creditors something (assuming the  
 10 Trustee can sell). Therefore, from a simple review of the Trustee’s analysis of the  
 11 factors applicable to a usual “9019 Motion” there is no compromise at issue.

12 Thus, without a compromise of controversy that gives rise to a “recovery”  
 13 under the Code, there is no authority for the Trustee to sell the Debtors’ Residence  
 14 and not pay the Debtors’ homestead exemption (as discussed above), through only a  
 15 voluntary assignment of a portion of the 3<sup>rd</sup> deed of trust. Analysis of the  
 16 bankruptcy court’s ruling confirms this as well. Nowhere in the bankruptcy court’s  
 17 ruling does it give one reason, legal or factual, why it believes there is a valid  
 18 compromise of any controversy before it. In fact, the only portion of the bankruptcy  
 19 court’s ruling on the Compromise Motion on this issue was:

20 “(counsel for the Debtors) you make a lot about whether  
 21 this falls under Rule 9019. I think it does. Clearly, the  
 22 third lien holder's position at the outset is, I want to be  
 23 paid in full now. That's what every lender's position is.  
 24 Trustee says, I can't help you. I can't administer the case  
 25 on that basis. Trustee counters and says, I can administer  
 it under the following circumstances. You got to give up  
 part of your lien. You got to transfer it to the estate.”<sup>38</sup>

26 <sup>35</sup> EOR 00098 at lines 5-6.

27 <sup>36</sup> EOR 00098 at lines 7-14.

28 <sup>37</sup> See *In re A & C Props*, at 1380.

<sup>38</sup> EOR 00593-00594 [Transcript for March hearing at page 20, line 24-page 21, line 6].

1  
2 The bankruptcy court reasoning, simply put, shows no controversy. Instead,  
3 the bankruptcy court describes what every creditor wants from a bankruptcy- that  
4 they be paid. Though the creditor wants to be paid and the bankruptcy court thinks  
5 payment to creditors would be a “spectacularly good result for creditors,” the  
6 court’s ruling that “(t)hat’s a reason to approve (the Compromise Motion) right  
7 there,” is not what the Code proscribes.<sup>39</sup> There is no doubt that the Debtors would  
8 like to see their creditors paid as well, but not at the expense of their homestead  
9 exemption and the displacement of their family of five, which is also not proscribed  
10 under the Code.

11 This is nothing more than a business transaction between the Trustee and  
12 FCS. So, does a business transaction give rise to authority under the Code to  
13 manufacture a “compromise” motion and obtain an assignment of a portion of  
14 FCS’s lien under the guise of a “105 motion”? In other words, does section 105  
15 allow the Trustee to call the voluntary assignment of a portion of the 3<sup>rd</sup> deed of  
16 trust a “recovery of a transfer” and then sell the Residence without payment of the  
17 Debtors’ homestead exemption because this is somehow analogous to a situation  
18 under section 522(g)<sup>40</sup> where a debtor is not entitled to claim an exemption on  
19 “recovered” property? The bankruptcy court espoused that it did have such  
20 authority<sup>41</sup> but the answer must be a resounding “no.” The bankruptcy court’s  
21 reasoning for section 105 authority here is also misplaced. Certainly we do want  
22

23 <sup>39</sup> EOR 00594 [Transcript of March hearing at page 21, line 7-8].

24 <sup>40</sup> Section 522(g) provides: “(g) Notwithstanding sections 550 and 551 of this title,  
25 the debtor may exempt under subsection (b) of this section property that the trustee  
26 recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the  
27 extent that the debtor could have exempted such property under subsection (b) of  
28 this section if such property had not been transferred, if— (1)(A) such transfer was  
not a voluntary transfer of such property by the debtor; and (B) the debtor did not  
conceal such property; or (2) the debtor could have avoided such transfer under  
subsection (f)(1)(B) of this section.”

<sup>41</sup> EOR 00594 [Transcript for Mach hearing page 21, lines 17-21].

1 “trustees to come to court and say we want court approval for our agreements...”  
 2 but it does not follow that under section 105, the court may order that the Trustee  
 3 can manufacture a controversy and sell the Debtors’ Residence free and clear of  
 4 their homestead exemption, solely because the bankruptcy court has *said* the  
 5 assignment of a portion of the 3<sup>rd</sup> deed of trust is just *like* a “recovery” of an interest  
 6 in property that results from litigation or resolution of some controversy that was  
 7 brought about to undo improper and voluntary transfers by a debtor before filing the  
 8 case. That was the reason that section 522(g) was enacted. In other words, in order  
 9 for the Trustee to sell and not have to pay the Debtors’ homestead exemption, like  
 10 section 522(g) might facilitate, the court would have had to find that the Trustee  
 11 “recovered” something here, through the Compromise Motion. The Debtors did  
 12 nothing improper to justify a “recovery” of a portion of the 3<sup>rd</sup> deed of trust and to  
 13 justify disallowance of their homestead exemption. The Debtors fell on hard times  
 14 and ended up with an over encumbered Residence, plain and simple.

15 The Trustee asserted he was not seeking to sell pursuant to “522(g) or a 510  
 16 (c) situation” and that “the agreement (with FCS) is not an equitable subordination  
 17 agreement...”.<sup>42</sup> Instead he argued that the sale was allowed because of “522(c),  
 18 which provided that an exemption does not apply against a voluntary mortgage or  
 19 deed of trust.”<sup>43</sup> Again, this demonstrates the Debtors’ position; there is no  
 20 argument that the Debtors’ homestead exemption comes after consensual liens, but  
 21 there is no statute that gives rise to powers of sale of the Residence by a lienholder  
 22 (FCS or the Trustee) other than through a lawful state law prescribed foreclosure.

23 However, in an effort to support the “spectacular” result the bankruptcy court  
 24 saw for creditors here, and after acknowledging that section 522(g) was not the  
 25 statute that would facilitate the Trustee’s right to sell the Debtors’ Residence,<sup>44</sup>  
 26

27 <sup>42</sup> EOR 00589 [Transcript for March at page 16, lines 5-7].

28 <sup>43</sup> EOR 00589 [Transcript for March at page 16, lines 7-11].

<sup>44</sup> EOR 00597 [Transcript for March hearing at page 24, line 4].

1 without paying all other junior secured creditors and the Debtors' homestead  
 2 exemption, as required by the Code (and discussed above in relation to *Jevic*), the  
 3 bankruptcy court then switched its position and stated it believed "there (was) a  
 4 compromise of a dispute here."<sup>45</sup> But what is the "dispute" the court refers to here?  
 5 It is not one at all when you look at actual ruling of the bankruptcy court. The  
 6 bankruptcy court specifically holds that the alleged "dispute"/controversy is simply  
 7 the creditor/FCS agreeing to take less on payment of its claim *if* the Trustee can  
 8 somehow sell the Debtors' Residence and get FCS around the foreclosure laws in  
 9 California.<sup>46</sup> In exchange for a promise by the Trustee to take action (*i.e.* sell the  
 10 Residence), the creditor/FCS is agreeing to "subordinate" its claim to other creditors  
 11 that are *not* next in line to be paid; a right it does not have in accordance with  
 12 *Jevic*.<sup>47</sup> That is simply not a controversy/dispute to be resolved and "blessed" by a  
 13 compromise motion under Rule 9019 and such a ruling is an abuse of the court's  
 14 discretion.

15 The Trustee was not arguing in his papers or at the first hearing on the  
 16 Motions that he was seeking to "recover" a portion of FCS's lien and sell pursuant  
 17 to 522(g) or analogizing this case to same.<sup>48</sup> There was no controversy about FCS's  
 18 lien, the bankruptcy court confirmed this, as well, when it held that "(a)ll parties  
 19 agree that the third deed of trust is **valid** (*emphasis added*)."<sup>49</sup> Therefore, FCS's lien  
 20 would not have given rise to a complaint/controversy of any type, that would lead to  
 21 a "recovery" of something.

22 However, after the initial briefing and the first hearing on the Motions, the  
 23 Trustee likely realized that he needed a legal connection to facilitate the sale under  
 24 the Code even if the assignment contained in the Compromise Motion was  
 25

26 <sup>45</sup> EOR 00594 [Transcript for March hearing at page 21, lines 13-14].

27 <sup>46</sup> EOR 00594 [Transcript for March hearing at page 21, lines 1-6].

28 <sup>47</sup> *Id.*

<sup>48</sup> EOR 00589 [Transcript for March hearing at page 16, lines 5-8].

<sup>49</sup> EOR 00597 [Transcript for March hearing at page 26, line 19-20].

1 approved. This revelation likely came from the bankruptcy court's comments  
 2 regarding the "avoiding" or "recovering in part a lien on property" when it ruled as  
 3 follows:

4 "...there's absolutely nothing unusual with the Trustee  
 5 avoiding in part or recovering in part a lien on property.  
 6 That happens all the time. Well, Debtors do it on the other  
 7 side. Debtors regularly file 522(f) motions to avoid liens,  
 8 and they keep the property. Trustees on the other side  
 9 regularly file complaints under 547 or 548 or 544 to avoid  
 10 liens on property that the Trustee will eventually sell. It's  
 11 very common. There's nothing unusual whatsoever in a  
 trustee attacking a lien or getting assignment of the lien and  
 then selling the property subject to lien. That's ordinary  
 course of business."<sup>50</sup>

12 However, the bankruptcy court then goes on to prove the point that Debtors  
 13 were trying to make when it holds that "522(g)...isn't relevant here."<sup>51</sup>

14 After the first hearing on the Motions, the Trustee went back to the drawing  
 15 table to try and fill the gap between obtaining a piece of a lien against the Residence  
 16 through a contrived compromise and getting to a sale authorized under the Code  
 17 through said "compromise." Fortunately for all debtors who end up in troubled  
 18 times in bankruptcy with overencumbered homes that they will need to address after  
 19 their bankruptcy to stay in their family home, the Trustee came up with no solution,  
 20 other than to argue that which the bankruptcy court already stated was not  
 21 applicable to the case at issue. In enters *In re Roach*.<sup>52</sup>

22 In the Trustee's supplemental brief in support of the Compromise Motion, the  
 23 Trustee asserts that his receipt of the *voluntary* assignment of FCS's lien is "similar"  
 24 to the assignment the trustee in *Roach* received. However, there is no law to support  
 25 this and there were two major differences of which the Trustee concedes to both (i.e.  
 26

27 <sup>50</sup> EOR 00596-00597 [Transcript of March hearing at page 23, line 18 through page  
 28 24, line 3].

<sup>51</sup> EOR 00597 [Transcript of March hearing at page 24, line 4].

<sup>52</sup> *Roach v. Marshack (In re Roach)* (B.A.P. 9th Cir. 2019) (*Unpublished*).

1 no litigation, especially relating to a 522(g) transfer/something the Debtors did; and  
 2 no 510 subordination agreement obtained).<sup>53</sup>

3 First, in *Roach*, the Trustee was involved in litigation with the lender to  
 4 which the debtor had given a voluntary lien on the debtor's residence.<sup>54</sup> The *Roach*  
 5 trustee ultimately settled the litigation, by filing a motion to approve a compromise  
 6 (like the Trustee did here) of real litigation with the lender (which is not present  
 7 here).<sup>55</sup> This is the first key to avoiding the effect of the Debtors' homestead  
 8 exemption on the sale proceeds from their Residence, under 522(g), and an  
 9 important difference from the case at hand, where there is admittedly no litigation to  
 10 be compromised and no "recovery" to be obtained by the Trustee.

11 Second, the trustee in *Roach* received the assignment from the junior  
 12 lienholder through a "subordination agreement pursuant to Section 510 of  
 13 the...Code" as part of the settlement.<sup>56</sup> This type of agreement is not present here.  
 14 As discussed above, the bankruptcy court has found 522(g) does not apply here,<sup>57</sup>  
 15 and the Trustee has conceded that as well.<sup>58</sup> This subordination agreement coupled  
 16 with approval of same through a compromise of a real dispute between the Trustee  
 17 and the lender gave rise to the result in *Roach* (an unpublished opinion where the  
 18 debtor did not oppose the compromise) where the debtor's homestead exemption  
 19 did not attach to the proceeds the lender carved out, all pursuant to section 522(g).

20 Neither of these two key facts exist that would give rise to a sale pursuant to  
 21 section 522(g) and/or a disallowance of the Debtors' homestead exemption on sale  
 22 proceeds from the Residence. Section 522(g) was enacted to preclude debtors from  
 23 claiming an exemption in property for which they had made voluntary, but possibly  
 24

25 <sup>53</sup> EOR 00514, lines 10-13.

26 <sup>54</sup> EOR 00513, lines 1-3.

27 <sup>55</sup> EOR 00513, lines 3-6.

28 <sup>56</sup> *Id.*

<sup>57</sup> See Footnote 51 above.

<sup>58</sup> See Footnotes 42 & 43 above.



1 avoidable, transfers of property interests before filing and which a bankruptcy  
2 trustee had worked to set aside/recover for the estate. Wrong-doing is not alleged  
3 anywhere in the Compromise Motion, therefore, why would the Code allow the  
4 bankruptcy court to sell the Debtors' Residence and not pay their homestead  
5 exemption from the sale proceeds? The bankruptcy court's answer to his question is  
6 its powers under section 105. However, as discussed below, that is an abuse of the  
7 court's discretion and a misuse of those powers.

8 FCS agreed to assign the bankruptcy estate a portion of its deed of trust in  
9 hopes of avoiding the foreclosure laws in California. Is the Trustee now doing  
10 business as/standing in the shoes of a lender, even if the Compromise Motion is  
11 approved in accordance with Rule 9019 or section 105 of the Code? Yes. What can  
12 any lender do with a deed of trust that is in default? They can foreclose. Therefore,  
13 Debtors submit that even if it is lawful for the Trustee to receive "an assignment" of  
14 a portion of the 3<sup>rd</sup> deed of trust, as some type of business "deal," there is nothing  
15 that then allows the Trustee, as a holder of a piece of that deed of trust, to simply  
16 sell the Residence and not pay the Debtors' homestead exemption. The bankruptcy  
17 court's "105 powers" cannot afford the Trustee this right either. In fact, the Trustee  
18 really only asserted authority he didn't have, to take an action the Code does not  
19 allow- sell an overencumbered asset that should have been abandoned from the  
20 estate.

21 Therefore, if there is no controversy to compromise, there is nothing for the  
22 Trustee to "recover." The Trustee's reliance on *Roach* to avoid paying the Debtors'  
23 homestead exemption, and sell pursuant to the subordination rights that the trustee  
24 in *Roach* sold under, is wholly misplaced. The law, even section 105, dictates that  
25 the portion of the Compromise Motion, which purports to convert a simple business  
26 deal between the Trustee and FCS into a resolution of a controversy which results in  
27 a "recovery" of a nonexempt asset, should be denied.

28 //



**F. Bankruptcy Code Section 105, Longstanding Policies and Equity Weigh Against a Trustee Selling Fully Encumbered Property and Evicting Debtors**

Debtors were aware when they filed their chapter 7 petition that their home was underwater when the tax liens were taken into account. They also were advised that – because trustees are generally prohibited from selling fully encumbered property - they could expect to discharge their dischargeable debts and receive a fresh start from the bankruptcy, which would then allow them to address the secured debts while maintaining their residence. The Trustee and FCS have orchestrated a plan which would destroy those dreams and have the dire consequence of evicting a family of five from their home. The bankruptcy court blessed this collusion and actually applauded the Trustee’s ingenuity. But the bankruptcy court overlooked the fresh start purpose of bankruptcy and the downside to all debtors if such schemes are countenanced.

Section 105(a) of the Bankruptcy Code gives the bankruptcy courts the power to issue any order that is necessary or appropriate to carry out the provisions of this title. One of the provisions of “this title” (the Bankruptcy Code) is to distribute estate assets in the order of priority set forth in section 507. Another is to honor the exemptions allowed under section 522. Either of those Code sections gave the bankruptcy court here the power to deny the Trustee’s “Compromise” and abolish the order of distribution orchestrated by the Trustee and FCS. After all, several courts have noted that to allow trustees and creditors to dictate how estate funds are allocated “would be improper.” The *Turnage* court used that polite term but others have been more stridently opposed, as discussed above. And no wonder, because this outcome is an abomination, to be struck down, not admired.

Several of the cited cases explained why a trustee normally is prohibited from selling a fully encumbered asset, as established by the United States Trustee’s Chapter 7 Handbook and ample case law, including a much-cited case from the

1 Ninth Circuit BAP, *In re KVN*, 514 B.R. 1 (9th Cir. BAP 2014). *KVN* dealt with a  
 2 trustee who had made a deal with a creditor for a carveout for the estate if the estate  
 3 auctioned personal property worth far less than its secured claim. The bankruptcy  
 4 court denied the stipulation, perceiving that only the trustee would benefit, despite a  
 5 promise to use some funds to pay unsecured creditors. This was a corporate  
 6 bankruptcy with no exemptions in play and no junior liens.

7 On appeal, the BAP reversed the outright denial and remanded for a factual  
 8 determination on whether there was a substantial benefit to the estate. However, in  
 9 doing so, it discussed at length why “The General Rule [is] That the Sale of Fully  
 10 Encumbered Property is Prohibited,” a caption in the opinion. *Id.*, at 5. It cites to a  
 11 myriad of caselaw, mostly from bankruptcy courts, all of which acknowledge  
 12 “universal recognition” that such sale is prohibited. The BAP also references the  
 13 Handbook for Chapter 7 Trustees promulgated by the Office of the United States  
 14 Trustee: “Generally, a trustee should not sell property subject to a security interest  
 15 unless the sale generates funds for the benefit of unsecured creditors.” *Id.*  
 16 Summed up, the BAP concluded that such sales were generally improper and that  
 17 the proper action is to abandon the property. *Id.* at 6.

18 The *Christensen* and *Bird* decisions also impress the principle that it is not  
 19 within a trustee’s normal fiduciary duties to make deals so that he can sell fully  
 20 encumbered property. The proper disposition is abandonment. *Bird*, 577 B.R. at  
 21 377-379; *Christensen*, 561 B.R. at 205.

22 Despite these admonitions, the Trustee here, with the bankruptcy court’s  
 23 blessing, defied the general rule and went out of his way to create a scenario which  
 24 would dispossess the Debtors of their home without any homestead exemption  
 25 funds to foster a fresh start. Debtors have cited numerous legal reasons why this is  
 26 wrong. But what about equity? Should trustees be encouraged to evict debtors  
 27 from their homes by colluding with creditors to create “equity” which the estate can  
 28 grab, ignoring homestead exemptions and leaving debtors homeless and penniless?

1 What ever happened to that ubiquitous fresh start for the honest but unfortunate  
2 debtors?

3 The underlying bankruptcy court's decision encourages trustees to go out of  
4 their way to try to sell homes which should be abandoned. Although not  
5 "precedential" it sets a precedent which should make every debtor's counsel  
6 shudder. How can they advise their clients to use their ample homestead  
7 exemptions to protect the equity in their homes when there are trustees out there  
8 who will labor to create a scenario that sells the home while ignoring the homestead  
9 exemption? If the Trustee here is allowed to make a deal with a junior secured  
10 creditor that allows sale of the house without honoring the homestead exemption,  
11 then can't every trustee do the same with every property? Many junior creditors,  
12 even when "in the money," might jump at the chance to be paid a discounted sum  
13 on their junior debt and be done with it. Where would it stop?

14 Debtors suggest it stops here with reversal.

## 15 **VII. CONCLUSION**

16 For the reasons stated above, Debtors request this court to reverse the  
17 decisions of the bankruptcy court so that they might save their family home.

18 Dated: July 14, 2023

Respectfully submitted,  
SHAW & HANOVER, P.C.

20 */s/ Summer Shaw*

21 \_\_\_\_\_  
22 Summer Shaw/Meredith A Jury (Of  
23 Counsel), Attorneys for Appellants,  
24 Marcos & Natalie Romero  
25  
26  
27  
28

**DISCLOSURE STATEMENT REQUIRED BY FED. R. BANKR. P. 8012**

(a) There are no nongovernmental corporations that are parties to this proceeding.

(b) (1) Each debtor is named in the caption. There are no other debtors who are not named in the caption.

(2) There are no debtor corporations that are parties to this appeal.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**Certificate of Compliance**

The undersigned certifies that the Opening Brief by Appellants, dated July 14, 2023, complies with the type-volume limitations of Federal Rule of Bankruptcy Procedure 8015(a)(7) because the text of brief contains 10,526 words (excluding the parts exempted by the rules) according to Microsoft Word, the word-processing program on which the brief was prepared.

Dated: July 14, 2023

/s/ Summer Shaw  
Summer Shaw

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

1  
2 **Certificate of Corporate Disclosure and Statement of Interested Parties**

3 The undersigned certifies that the following parties have an interest in the  
4 outcome of this appeal and/or have at least a ten percent (10%) interest in an entity  
5 in a party to this appeal. Appellants makes these representations to enable the judge  
6 on appeal to evaluate possible disqualification or recusal.

- 7
  - Todd A Frealy, Chapter 7 Trustee and Appellee
  - Marcus & Brenda Romero, Debtor and Appellant

9 Dated: July 14, 2023

10 /s/ Summer Shaw  
Summer Shaw

**Certificate of Related Appeals**

The undersigned certifies that the following are known appeals that are related to this appeal: **None.**

Dated: July 14, 2023

/s/ Summer Shaw  
Summer Shaw

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28



## PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is: **44-901 Village Court, Suite B, Palm Desert, CA 92260**

A true and correct copy of the foregoing document entitled (*specify* **APPELLANTS' OPENING BRIEF** will be served or was served (a) on the judge in chambers in the form and manner required by L.R. 5-4 in the manner stated below:

1. **TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF):** Pursuant to controlling General Orders and L.R 5-3.3, the foregoing document will be served by the court via NEF and hyperlink to the document. On **July 14, 2023**, I checked the CM/ECF docket for this case and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

- Summer M Shaw ss@shaw.law

☐ Service information continued on attached page

2. **SERVED BY UNITED STATES MAIL:**

On (date) 07/14/2023, I served the following persons and/or entities at the last known addresses in this case by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

**APPELLEE (Brief only)**  
**Todd A. Frealy**  
**3403 Tenth Street Suite 709**  
**Riverside, CA 92501**

☐ Service information continued on attached page

3. **SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL** (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 (d)(3) and/or controlling L.R. 5-4, on **07/14/2023**, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

**APPELLEE: Emailed Brief & Appendix & EOR to: taf@lnbyb.com** (with Appellee's authorization)

☐ Service information continued on attached page

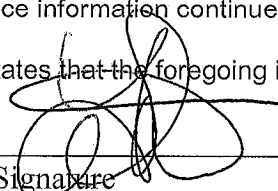
I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

07/14/2023

Date

Teresa Stone

Printed Name

  
 Signature

This form is mandatory. It has been approved for use by the United States Bankruptcy Court for the Central District of California.

June 2012

**F 9013-3.1.PROOF.SERVICE**